UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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PLUMBERS, PIPEFITTERS & MES LOCAL UNION NO. 392 PENSION FUND, on Behalf of Itself and All Others Similarly Situated,

Plaintiff,

v. 11 CV 5097 (JFK)

FAIRFAX FINANCIAL HOLDINGS LIMITED, ODYSSEY RE HOLDINGS CORP, V. PREM WATSA, TREVOR J. AMBRIDGE, GREG TAYLOR, M. JANE WILLIAMSON, ROBERT HARTOG, ANTHONY F. GRIFFITHS, BRADLEY P. MARTIN, BRANDON SWEITZER, and PRICEWATERHOUSECOOPERS, LLP, CHARTERED ACCOUNTANTS, TORONTO, ONTARIO, CANADA,

Defendants.

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New York, N.Y.
July 16, 2012
10:55 a.m.

Before:

HON. JOHN F. KEENAN

District Judge

APPEARANCES

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BY: CHRISTOPHER DAVIES, ESQ.
SCOTT M. LITVINOFF, ESQ.

(In open court)

THE COURT: This is in the matter of Plumbers Pipefitters & MES Local Union No. 392 Pension Fund v. Fairfax Financial Holdings Limited, et al. And first starting with, as I understand it, for all the defendants other than PricewaterhouseCoopers, is going to be Mr. Polovoy. Correct?

MR. POLOVOY: Yes, sir.

THE COURT: How do you do.

MR. POLOVOY: Good morning.

May it please the Court, Brian Polovoy with Shearman & Sterling. As your Honor noted, I represent all the defendants

in this case, except for PricewaterhouseCoopers.

Your Honor, this is a securities action, and there are numerous grounds on which to dismiss this action. Many of them existed when the plaintiff first filed this lawsuit over six years ago on behalf of another plaintiff.

THE COURT: I think that was a case before Judge Daniels?

MR. POLOVOY: Excuse me?

THE COURT: That was the case before Judge Daniels?

MR. POLOVOY: Correct. And certain additional grounds exist by virtue of the passage of six years since that time, and additional grounds based on the nature of this plaintiff itself.

Your Honor, there was no fraud here. The allegation is that this is an accounting fraud. The allegation is that the defendant company, a Canadian financial company that owns insurance companies, fraudulently accounted for its cost of finite risk reinsurance. The plaintiff's complaint, for all its length, essentially boils down to that alleged accounting fraud. When one looks at it, for all its length, there are two points. There was an SEC investigation of Fairfax Financial, which is correct, and that the company many months later had an accounting restatement, which is also correct. When we cut to the nub of it, your Honor, as to the SEC investigation, there was an industry-wide investigation into dozens of insurance

companies as to how they accounted for finite risk reinsurance, and critically, the SEC, as to Fairfax, closed the investigation without taking any action.

As to the restatement that plaintiff makes so much about, only two of 200 finite risk reinsurance contracts were restated. And the restatement -- and this might make this a rare securities fraud action -- the restatement ended up increasing the net earnings of the company during the restatement period and had no effect on shareholders' equity. So it's difficult to see how a buyer of Fairfax stock could argue that they were defrauded, when the alleged fraudulent accounting, a mistake that was restated, ended up increasing the net earnings during that period.

And during this entire time, your Honor, during this entire time, the three individuals that plaintiff's counsel accuses of fraud were buying millions of dollars of their company's stock during the entire class period. There is case after case where scienter is found because the officer defendants were selling the stock when allegedly artificially inflating the stock. This is a case where the plaintiffs were buying. And in one case, one of the officers, the CEO, bought over $6 million worth of stock during the class period.

Let me begin, then, your Honor, with the ground that did not exist when plaintiff's counsel first filed the lawsuit over six years ago, which is the statute of repose. There is

no dispute that the statute of repose, both the '33 Act and the '34 Act claims, had run by its terms.

THE COURT: Colleagues of mine in this district have gone each way, right?

MR. POLOVOY: That is correct, Judge.

THE COURT: Judge Stein ruled against your position, as I understand it.

MR. POLOVOY: Judge Stein has ruled in our favor.

THE COURT: Castel and Kaplan have ruled in favor of your position.

MR. POLOVOY: And the issue is before the Second Circuit. And the briefs --

THE COURT: All four cases?

MR. POLOVOY: Two of the cases. They've been consolidated. One of them went one way. The other I believe went the other way. There is an interlocutory appeal.

Our point here, your Honor, unless your Honor would like to go through each of those cases, we believe it is clear when you look at the analysis that unlike *American Pipe*, when one has a bifurcated statute, the statute of limitations, two years, statute of repose, five years, that the five years can't be tolled. And the briefs in those cases of all of your colleagues discuss whether or not that later period could ever be accurately tolled. And obviously, if the Second Circuit rules in our favor on that, that would be dispositive of our

case. Our point here, your Honor --

THE COURT: You don't want me to wait for that, do you?

MR. POLOVOY: The oral arguments have not been set. I would leave that to you. But that would be dispositive.

Our point here is that even if the Court says that equitable tolling is in some circumstances allowed, just because equitable tolling is allowed in some circumstances doesn't mean that this Court should invoke equity for this plaintiff. And this is a case where this plaintiff sat on the sidelines for years, was told that it should sue, it should file its own lawsuit, and it chose not to. And there is nothing alleged in the plaintiffs' opposition brief that suggests that equity is warranted here.

THE COURT: And *American Pipe* dealt with the statute of limitations, not with statutes of repose?

MR. POLOVOY: That's correct, your Honor.

THE COURT: Let me ask you this. In reading all this and thinking about it, is it really fair to the plaintiff not to toll the statutes of repose? The plaintiffs, they didn't waste any time filing after the motion to intervene was denied, did they?

MR. POLOVOY: A year and a half.

THE COURT: Was it?

MR. POLOVOY: Over a year. When the motion to

intervene was denied, which was in 2010, I believe, July of 2010 if I'm not mistaken, the CI Funds, who was the plaintiff in that case, did not appeal. No appeal was taken of the decision by Judge Daniels, except the Plumbers Fund, which is their new plaintiff now, that plaintiff, as a non-party, filed a notice of appeal from the decision dismissing the CI Funds case. So what they're essentially saying is -- it's unprecedented -- is that when they, as a non-party, appealed from the dismissal of a different party's lawsuit, that they were in essence tolling the time within which they themselves should bring an action. And we said all along that that doesn't work, that they should file another lawsuit. And the Second Circuit made very clear, it said, you should have filed your own lawsuit, and its exact words were counsel's failure or refusal to file its own lawsuit to the extent that that failure has any effect on the statute of limitations defense -- that counsel, plaintiff's counsel here, that their failure or refusal to file a lawsuit didn't give them standing there. And whether that has any effect on the statute of limitations obviously would be for your Honor to decide.

But to be clear, CI Funds, over a year went by between when CI Funds decided not to appeal dismissal by Judge Daniels and July of 2011, when this plaintiff filed its own lawsuit.

Your Honor, the main issue -- I don't want to argue over -- those are not technicalities, because the statute of

repose is one intended to give defendants true repose as opposed to a statute of limitations, which is simply intended to put them on notice. This is a case that my client has been accused of fraud now for over six years.

Let's look at what the actual fraud allegations are. These are the grounds that are listed in the motion to dismiss that I filed back in 2006, and still exist today.

The first is the alleged misstatement. And the misstatement here, again, we say there is no actionable misstatement. The case is about finite risk reinsurance, and in order to be accurate there was a restatement, which means there was an acknowledgment that the accounting had to be restated. The accounting that was restated ended up with the finite risk transaction's increasing net earnings and having no effect on shareholder equity. We're at a loss to understand how a buyer of Fairfax stock during the class period could argue that an accounting error that showed that the net earnings, when it was buying the stock, were understated is somehow an actionable misstatement. And I searched in the opposition brief and I do not see any response to that. And absent an actual misstatement, there's no securities fraud case.

But then we get to whether or not there was a misstatement, whether that is fraud, they have alleged fraud and obviously they have a high burden of alleging facts,

proving facts that give rise to a strong inference that my clients acted with an intent to defraud.

THE COURT: It is saying it was reckless. They're not saying it was intentional, are they?

MR. POLOVOY: Well, if they're not -- they'll tell you what they say. They certainly are not alleging motive and opportunity, so they do have to then have the corresponding higher burden of conscious disregard or recklessness.

But with motive and opportunity, it's not enough to just say I'm going to have to prove that I'm going to focus on conscious disregard, because when your Honor gets to the balance test, it's one thing to say we have no motive; it's a different thing when the facts suggest the complete opposite. And there is case after case in this district and elsewhere that says when officer defendants are purchasing stock of their company during the class period, that that entirely vitiates any argument that there was a fraud. Why would the CEO of this company purchase over $6 million of stock in this company if he was running a supposed huge fraud to artificially inflate the stock? And the other two individual defendants similarly were buying the stock during this class period.

So you're right that there's no motive argument, but we suggest that simply ignoring our motive argument is something that they can't do. The case law supports that as well.

THE COURT: You pointed out that the bottom line was benefited, that there were profits. But wasn't there a negative impact, as the plaintiffs argue, on shareholder equity? Isn't that sufficient for materiality?

MR. POLOVOY: There was none. And they do argue that in their opposition brief. And our reply brief actually cites, if you look at the restatement itself, because the numbers are what they are and your Honor is obviously permitted to look at that, it is in the complaint, and they are telling you what the restatement was, when one looks to the actual restatement, and this is in our reply brief, at Exhibit P to my affidavit, at page 13 if I'm not mistaken, it says there was no impact on shareholder equity. The restatement of these two finite risk reinsurance contracts had no impact on shareholder equity. It increases. The net earnings during the period of the restatement increase.

Let me be a little more precise. One of the two contracts that was misstated had no effect. The other one ended up being an increase in equity. You're correct, your Honor, that they are in conscious disregard. They had the existence of the restatement itself, which we all know is not enough. That shows there was a mistake, not that there was scienter.

And then we have this host of confidential witnesses. And I will not, in the time we have this morning, go through

what each and every one of them said. The briefs, I believe, show in some detail why those do not give rise to an inference of scienter, much less a very strong inference of scienter. What I will note is, only one of those confidential witnesses even mentions finite risk reinsurance. That one didn't even work for Fairfax. And for the other confidential witness --

THE COURT: Number 9?

MR. POLOVOY: Number 9, correct. The other eight, they talk about various and sundry issues. They used the usual hyperbole that you see in these types of complaints. And they talk about issues -- there were other issues in that restatement that had nothing to do with finite risk reinsurance, and therefore aren't at issue in the case, because there was never any disclosure of them that caused the loss. Keep in mind when this restatement came up, the share prices of their equity went up. So they don't get loss causation by arguing something that is discussed in that restatement.

But, again, when you look to the balancing, you have on the one hand a restatement, and I have to deal with that, and that means there were mistakes in those financial statements, and that is not scienter. On the other hand, when you balance it, your Honor, you have the absence of motive, the absence of motive to defraud and the existence of a credible motive not to defraud. You have the fact that this alleged accounting fraud is only two of 200 of the contracts. If

you're going to use the wrong accounting method, reinsurance accounting versus deposit accounting, as part of the fraud, you don't do it for just 200.

And they also have -- and the complaint says this itself -- this is a very sophisticated and difficult issue of accounting, whether to use reinsurance accounting or deposit accounting. Shouldn't be surprised that there was a mistake on certain of those contracts. Not something they're proud of, but that certainly is not an indication of fraud.

And you have the fact that this restatement, at the end of the day, the reason why we know it was not fraud is that it increased the net earnings of the company and had no effect on shareholder equity. And during this whole time, you have these folks buying stock and the SEC closes its investigation.

Your Honor, with respect to loss causation -- again I'll just touch on that because I go through it in some length in the briefs -- they argue that we mischaracterize what their loss causation arguments are. Nine paragraphs of the complaint, they quite clearly only relate to finite risk reinsurance, but instead of getting into a war of words as to how we characterize the complaint, the Court can actually look at the disclosure itself. All the disclosures which are referenced in the complaint are attached to my declaration. They only apparently talk about this finite risk reinsurance. This other hodgepodge of alleged wrongdoing, what have you, are

never mentioned in any of the disclosures that are the ones that this plaintiff, like the plaintiff six years ago, alleged caused his loss. It's over a few months' disclosures of receiving subpoenas from the SEC. And that is what is alleged. That is what they alleged caused their loss, that is what they allege now caused their loss, and we are at one that the disclosure of the existence of the SEC subpoena is not loss causation. And all of these other allegations of wrongdoing have nothing to do with risk reinsurance.

Your Honor, if I might briefly touch on the second. And this is one of their examples where this plaintiff, the Plumbers Fund, has a problem that perhaps the original plaintiff on whose behalf they filed doesn't have, which is that this plaintiff bought all of his shares before the two offerings that he alleges violated Section 11 of the '33 Act, and it is very clear that one could not have purchased pursuant to an offering when one purchased all of its shares prior to that offering. Their only response is that your Honor should wait until class certification because that's the right time to deal with this. And as we cite at length in our brief, every single case in this district addressed that issue, and they make the exact same argument in numerous cases. They have said that you have to address standing on a motion to dismiss. And if they don't have standing here, which they do not, those claims should be dismissed.

That Section 11 claim is also another independent ground to dismiss. It is barred by the statute of limitations. Put aside the fight, which, as your Honor noted, in this courthouse there are many different views as to whether the statute of repose controls. The statute of limitations itself -- put aside the repose period -- the limitations itself was running for at least 15 months after the first case was dismissed.

THE COURT: I think I have your points. You're a little over your time. Thank you.

MR. POLOVOY: Thank you, your Honor.

THE COURT: All right. And it is going to be Mr. Litvinoff or Mr. Davies?

MR. DAVIES: Chris Davies, sir.

Chris Davies, your Honor, on behalf of PwC Canada.

Your Honor, I'm going to try to limit my points here to three areas. I believe the rest of them are addressed in the briefs. Of course I'd be happy to answer any of your questions. The first of those is with respect to loss causation. Plaintiffs here contend that the truth of the alleged fraud was revealed over a period between June 2005 and March 2006 in a series of court disclosures. Those disclosures, however, as they acknowledge in our opposition, never actually address Fairfax's financial statements. Rather, as they characterize it in their opposition, they refer to

serial disclosure investigations. And their contention in their opposition is that a serial disclosure investigation itself can amount to disclosure of financial impropriety or fraud. We don't believe that's true, your Honor. We believe that, instead, those disclosures between June 2005 and March 2006 concern the development of ongoing investigations by various U.S. government agencies.

The fact that those investigations were occurring and indeed the intensity of those investigations does not go to whether the financial statements were accurate or inaccurate. Mr. Polovoy discussed, of course, there was ultimately an error identified with respect to finite reinsurance. However, the disclosures concerning that error occurred in July and November of 2006, after the close of this class period.

Moreover, as we address in both our original brief and our reply, the disclosure of that error ultimately led to a substantial increase in the stock price, not a decrease. The plaintiffs here don't -- yes, your Honor.

THE COURT: Wasn't the correct disclosure based upon a misaccounting of figures that were audited by Price-waterhouseCoopers?

MR. DAVIES: I'm sorry, your Honor. I missed the question.

THE COURT: Wasn't the corrective disclosure based upon a misaccounting of figures that were audited by Price

WaterhouseCoopers? Isn't that enough for loss causation?

MR. DAVIES: But in this instance, your Honor, the only disclosures that pertain to misaccounting are from July of 2006 and November 2006, months after the class period ended. As a consequence, there can be no loss causation associated with them for the period of class. The only disclosures here, your Honor, have to do with investigations. And the topic associated with OdysseyRe has nothing to do with Fairfax's financial statements, which, PwC didn't audit these financial statements.

So, your Honor, they acknowledge, I believe at page 58 of the opposition, their argument here, their loss causation argument, is premised on this serial disclosure of the investigations, rather than of errors. And they cite two cases, your Honor. They cite one case, *Winstar*, that concerns an actual disclosure of financial statement errors. They say the second case, whose name is now eluding me, that actually refers to three things; it refers to SEC investigations, it refers to an internal investigation, and it refers to the fact that the company is going to suspend the release of its upcoming financial statements. Those cases are entirely inapposite in this instance where the disclosures pertain solely to the existence and developments in the government investigations pertaining to finite reinsurance.

Then as to scienter, your Honor, here, though there

are a fair number of pages that get into scienter, the PwC Canada scienter in plaintiff's papers, there is very little of substance. Our papers cover this, I think, in some depth.

THE COURT: The confidential witnesses don't say anything about you, do they?

MR. DAVIES: That's right. The confidential witnesses say nothing. Nor are they able to point to anything that any of our people, or PwC Canada itself, in fact knew. Rather, they rely largely on these red flags. I'll refer to only one of them, the one that concerns the known history of securities law violations. Presumably that would require both a history and a violation. Plaintiffs refer us to two supposed facts. One is a 2004 letter that was copied to a PwC partner, Kevin Dancey. That letter supposedly identified an inability to reconcile between securities held at Fairfax subsidiaries and Fairfax's own books. The company, even according to the complaint, responded to that letter. So far as the plaintiffs here allege, there is in fact no error that we know of in the company's response to the letter on which Mr. Dancey was copied, so it's unclear how that had anything to do with either a history or a violation.

The second thing to which they cite is the June 2005 SEC subpoena itself, which, again, given the time period covered by this claim, doesn't reveal a history of securities law violations.

So as to scienter, your Honor, we believe that the absence of any confidential witness testimony and the absence of any actual fact alleged with respect to PwC's own knowledge and a failure to cite any meaningful red flags means there is no scienter with respect to PwC Canada.

The last topic I wanted to address, just to follow-up on the discussion you had with Mr. Polovoy on the statute of repose, I would point out only that the three cases that favor our side in this discussion, the ones cited by Judges Kaplan and Castel, addresses the Rules Enabling Act. The two cases that go in the other direction do not. Nor are we aware of any case cited that refers to cites and addresses the Rules Enabling Act in connection with *American Pipe*'s applicability to a statute of repose that favors the plaintiff's side. We therefore believe there's a strong statutory argument, separate and apart from the policy arguments that you discussed with Mr. Polovoy, favoring defendant's position on the statute of repose.

Unless you have any other questions, your Honor, that was all I had at this time.

THE COURT: Thank you very much. And arguing for the plaintiff, I take it is going to be Mr. Jarvis? Is that right?

MR. JARVIS: I'm going to take the merits argument. Ms. Nguyen is going to take the statutes argument. She'll take about five minutes and I'll take about 15.

THE COURT: OK. And you are Mr. Jarvis?

MR. JARVIS: I am Jeff Jarvis, your Honor.

THE COURT: And you are Ms. Nguyen.

MS. NGUYEN: Yes, your Honor.

THE COURT: OK. Fine.

MS. NGUYEN: Good morning, your Honor. Angelina Nguyen. I'll briefly address the statute of repose issue. The Tenth Circuit in *Joseph v. Wiles* and a majority of district courts nationwide have held that the three statutes of repose applicable here under the Securities Act and the Exchange Act are actually satisfied by all unnamed class members if a named plaintiff files such claims within --

THE COURT: And what's the name of that case?

MS. NGUYEN: The Tenth Circuit case is *Joseph v. Wiles*.

THE COURT: And what about the other case in the Tenth Circuit, *Anixter v. Home Stake Production*?

MS. NGUYEN: *Joseph v. Wiles* actually discusses that case, your Honor.

THE COURT: All right. Go ahead.

MS. NGUYEN: We submit that those courts are correct, your Honor, and this court should follow their approach, because a class action serves claims on behalf of unclaimed class members who should be treated as though they have been named plaintiffs during the pendency of the class action or

until class certification is denied. That's what the Supreme Court said in *Chardon v. Fumero Soto*. Therefore, the unnamed class members are deemed to satisfy the statute of repose, based upon the filing by a named plaintiff within the three-year period, even if that named plaintiff is subsequently found deficient or class certification is denied. The Supreme Court applied this analysis in the *American Pipe* and in *Crown Cork*, and held that the limitations period was satisfied for absent class members by a named plaintiff filing the action within the limitations period. The Supreme Court recognized that unless the statute of limitation was tolled by the filing of the class action, class members would be unable to rely on the existence of the suit to protect their rights. Only by intervening or taking other action prior to the running of the statute would they be able to ensure their rights were not lost.

In the absence of tolling, a putative class member who fears that class certification would have every incentive to file a separate action prior to the expiration of its own period. The result would be a needless multiplicity of actions -- precisely the situation that Fed.R.Civ.P. 23 and *American Pipe* were designed to avoid.

This rationale applies equally to the statute of repose. Even though the doctrine under *American Pipe* has come to be known as *American Pipe* tolling, as numerous courts have

explained, including *Joseph v. Wiles* in the Tenth Circuit and as Judge Stein set forth in his opinion in *Citigroup*, it is not really a matter of tolling, but, rather, of tolling that the timing requirements for filing the suit were satisfied by the unnamed class members. Accordingly, distinctions of *American Pipe* as involving a statute of limitations to which equitable tolling can apply rather than a statute of repose to which it cannot are inapposite and frankly irrelevant.

For the same reason, the line of cases, including Judge Kaplan's and Castel's opinions, that rely on *Allen v. Gilbertson*, which held that the statute of repose cannot be equitably tolled, that case, your Honor, *Lamp*, did not involve a class action, and therefore did not consider the same policy reasons and rationale behind *American Pipe* and the so-called tolling that *American Pipe* applied in order to preserve the class action rights, your Honor.

THE COURT: Didn't Judge Kaplan find that the language of the statute of repose was absolute, and didn't he write in his opinion -- how do you get around what he said, "If Congress had intended the statute of repose to apply differently to securities class actions, which are not uncommon occurrences, it certainly could have provided so. It still may. In the absence of further legislation, the court must apply the statute as written"? And isn't the statute as written that there's nothing after five years?

MS. NGUYEN: Yes, your Honor, but the same argument was made in *American Pipe*.

THE COURT: That was a statute of limitations, not a statute of repose.

MS. NGUYEN: The absolute bar language was the same in the statute of limitations, your Honor. It was emphatically absolute, providing that any action to enforce any cause of action under the antitrust laws in that case shall be forever barred unless commenced. That was in effect the statute of repose, your Honor. And the Supreme Court in that case held that the policy considerations behind Rule 23 did take that, absent class members satisfying -- it's not a matter of tolling, your Honor, but that the absent class members satisfy the time period.

If your Honor has no more questions for me, I will hand it over to Mr. Jarvis.

THE COURT: All right. Thank you.

Mr. Jarvis.

MR. JARVIS: Good morning, your Honor.

THE COURT: Good morning.

MR. JARVIS: I'm here to address the merits arguments, and as you might gather, I'm going to probably disagree quite a bit with some of the things that Mr. Polovoy stated to the Court regarding what this case is about and what in fact the statements that have been made by defendants are.

THE COURT: If you agreed we wouldn't be here.

MR. JARVIS: Excuse me, your Honor?

THE COURT: If you didn't disagree we wouldn't be here.

MR. JARVIS: That's pretty much always the case. Mr. Polovoy and I have done this dance before, so we have our lines down pat by now.

Mr. Polovoy talks and defendants do in their papers that this is a scheme dealing solely with finite reinsurance and they say it's just disclosures of investigations and no actual changes with anything to do with finite insurance and ultimate restatement. And I would take major issue with both of those statements. The case simply is not only about finite reinsurance and whether it was properly accounted for. As your Honor will gather from reading the papers and probably has, it is the plaintiffs' view that this case is about a company, Fairfax, that was in severe distress, from a reserve point of view. It didn't have enough money to reserve for the insurance that an insurance company had to reserve for its claim. It simply didn't have enough money. The company itself was threatened. So what did they do? They took a number of steps in fact to shore up the balance sheet. They sold some more equity. They sold pieces of certain businesses they owned. And certainly no one could argue that those are appropriate ways to increase your balance sheet. But they also did a whole

bunch of other things that weren't, because they couldn't close the gap by selling and that sort of thing. And what do we argue they did? We argue that they in fact misclassified finite reinsurance on $665 million worth of policies. A lot of money. We claim that they improperly accounted for offshore investments. They very conveniently lost money. They have one year, for example, 2005, where they had a $500 million claim related to Katrina. They lost $15 million on their U.S. investment. Very conveniently, they gained $400 million on an offshore investment where the only criterion for price, for valuing the investment, is the whim of the board of directors of the entity involved. They essentially needed 400. Our argument is, they made it up.

We have other asserted buyer issues related to Xenith and to accounting for fixed income investment.

But the goal here is, all of the things -- and it's not -- you know, the defendants want to focus on how much their net income increased or decreased over the net loss, how much was their net income increased or their net loss decreased. That is not what this law is about. We're not suggesting that they sought to inflate their financials with respect to the cash flow or earnings any particular year. The goal is that they were willing to sacrifice earnings in order to increase shareholder equity.

THE COURT: But if Fairfax's bottom line was improved,

even if it was by the misstatements, how does your claim go forward?

MR. JARVIS: But that's my next point. Let's just look at the finite reinsurance Mr. Polovoy went through, and in particular let's look at page 13 of the restatement, which is Exhibit 40 to Mr. Polovoy's declaration, Exhibit 4. I have a copy. I believe it's Exhibit 4 to Mr. Polovoy's. Maybe it's P. I'm I little confused. But at page 13 of the September 2006 restatement. And what it says in a footnote is, we know a couple, that we know comparing these stated amounts of shareholder equity and assets to the previous filed financial statements, we know that shareholder equity in 2003 was increased by $491 million, had to be restated down, in 2004 $465 million, in 2005 $426 million. Those are not insubstantial numbers. What Mr. Polovoy refers to is page 13, at the bottom of the page, where they specifically say what portion of shareholder equity was related to the reinsurance contracts as restated. And what they say is, there was no impact on shareholder equity in 2004 and 2005. I could just bring up the page, your Honor, if you like. They don't say, for example, what happened in 2002 and 2003. Just because they don't provide the information doesn't mean it didn't happen. They specifically said, no impact in '04-'05, that there had been no impact in '02, '03. And the annual report for '02 is the first day of the class period. Then they could have said

so. They didn't. I think the supposition is there was an impact in '02, '03. And we know that overall, shareholder equity in '03 was increased by $491 million as a result of their manipulations.

We also know that in 2002, their assets were increased by $353 million. And it is our view, because these two reinsurance contracts that were restated actually were rolled up in '04, that the impact of those was in '02 and '03, not in '04, which is why they could say in '04 and there was no impact, because those contracts were rolled up.

So we argue they actually got quite an enormous bottom-line benefit as a result of the -- in the area where they needed it. It was not in profit and loss but in assets available to support the reserves that they needed to have.

I will briefly touch on the restatement.

And I think that is really the key to this whole thing. Your Honor understands the fraud, and I'm sure your Honor does, that we've alleged, and understands that the impact -- that they can't say -- and Mr. Polovoy has said this a bunch of times -- there was no impact on shareholder equity during the class period. Well, the class period starts for the annual report for '02 and runs into '03, and there's absolutely nothing that says what those impacts were. They could have said none. They didn't, we presume because there were massive shareholder equity impacts. And I think we're entitled to that

presumption, that in fact it was due, at least in part, to those reinsurance contracts.

So there is in fact a material misstatement. And we've got to keep in mind that in fact there was a restatement that was made to this material. They indicate in the restatement of '06, they said they were all material; all these changes are material to the bottom line.

And the important piece that I don't want to forget, it all comes down to the point that, why do they do this? Because they had terrible, terrible internal control. There are tallies all over the place. But what do they say in the restatement? They have, "As of December 31, 2005, the following material weaknesses have been identified, including in management's assessment: The company did not maintain an appropriate accounting and financial reporting organizational structure." And he said "deficient complement of accounting personnel to support the activities of the company." "This control deficiency" -- I'm skipping stuff here. "This control deficiency appeared for each of the material witnesses described below."

Point 2. "The company did not maintain effective controls of completeness and accuracy of period-end financial reporting and period-end closing processes." "This control" -- skipping some stuff, "This control deficiency resulted in restatement of the company's consolidated financial statements

for the years ended December 31, 2001 through 2005," Four years or five years of financial statements.

Paragraph 3, "The company did not maintain effective control in the accounting for certain derivative instruments." It of course was FAS 133. Again they say that resulted in a restatement. "The company did not maintain effective control over the completeness and accuracy of the calculation of the income taxes," and certain other things. Again, it resulted in a restatement. It says, "Each of the controlled deficiencies described in 1 to 4 above could result in the misstatements of any of the company's financial statement accounts and disclosures that would result in a material misstatement to the annual or interim consolidated financial."

So this case is about a company that basically had an incentive, strong incentive, to increase the number of assets to save the company. And it admitted basically they were unable to account for things properly. So they have a strong incentive to do something in a certain way. All of the adjustments that I was discussing extensively in the complaint and in the brief go one way. They increase assets even if they have potentially a negative impact on earnings, or what they refer to, they had a positive impact on earnings, a negative impact on assets. That's what the restatement did. And that's the scheme.

And they have an incentive to do it. Mr. Polovoy

says, yeah, but I bought stock. That's true. All that means is they didn't expect to get caught, and they thought that once they got past their problems in '03 and '04, they'd have a high-level company. And that's actually probably what has turned out --

THE COURT: They bought the stock because they figured they won't get caught.

MR. JARVIS: I think that's quite -- most people who commit fraud, your Honor, in my view, don't expect to get caught.

THE COURT: So wait a minute. I thought your main theme here was recklessness. Now you're telling me it's intentional.

MR. JARVIS: I think it's both. It's sort of conscious disregard that they had some --

THE COURT: Oh, it is both. You're alleging intentional fraud, not just recklessness.

MR. JARVIS: That the alternative, both. I think there was intent to do this thing and I think that they were reckless in putting together financial statements.

THE COURT: Let me just shift for a second.

MR. JARVIS: Sure.

THE COURT: How have you established scienter regarding PricewaterhouseCoopers?

MR. JARVIS: Two things. One, I mean, I just read you

the restatement, the incredible lack of control. PricewaterhouseCoopers was their auditor during that entire period.

THE COURT: I'm aware of that.

MR. JARVIS: So those controls existed on PricewaterhouseCoopers' watch.

Two, there are also GAAP violations.

THE COURT: Those are the Canadian GAAP violations.

MR. JARVIS: Yes. The GAAP violations, I believe, are set forth in paragraphs 199 through 202 of the complaint, and the GAAS, Generally Accepted Auditing Standards, in 503 and 504.

Also, you know, we put forth in the complaint the fees that Price Waterhouse earned. Obviously they are entitled to fees for their work. There's no question there. However, when you look, and we did this analysis, where there was --

THE COURT: Go a little slower. We have the fastest court reporter in the whole Second Circuit, but...

MR. JARVIS: All these points we make -- thank you. I will slow down. Thank you, your Honor. We have the argument that's set forth in the complaint, you put the analysis in, you look at what the audit fees are for certain Fortune 500 companies, companies the size of Fairfax, and the audit fees paid to Price Waterhouse Canada were double for the period. They were incentivized by getting high fees. And the evidence of the fact that they were not doing their job, that they were

so incentivized, is the restatement itself.

THE COURT: Let me ask you two other questions, please. First, how did the press releases about the SEC investigation, how did they signal to the shareholders that plaintiff was engaging in "deceptive business practices," such as -- and I'm quoting -- "improperly accounting for intercompany transactions"? How do the press releases signal anything like that to the shareholders?

MR. JARVIS: I will at the outset acknowledge that the press releases primarily deal with SEC and DOJ investigations relating to accounting for finite reinsurance. I'm not going to suggest otherwise. However, the way you get there, your Honor, is you have to look at the context in which these press releases are being made, what information is available to the market. From the time that they essentially became public companies, there was a lot of reporting and other contexts in which the market was concerned, because a lot of people were reporting on it, your Honor, that there were financial irregularities that Fairfax wasn't accounting for things properly. And that was always an overhang on the stock. Ultimately there was filed a suit against short sellers for claiming to have established that particular overhang.

So what happens when people are out there, investors who are concerned? This is a company that's not transparent. It is very, very complicated. And there are lots of

allegations that the accounting for all kinds of things in this company was wrong. They also have the SEC investigations, albeit only as to a piece of the business, but they're continual. First this was denied. They said that the SEC and the DOJ wasn't interested. And then, OK, we have to admit that the DOJ is sort of interested in what we're doing. And then they said, it's only about an industry-wide thing. But as it slowly works its way through, you realize that by the end, in particular the March 22, 2006 press release, the fact that the DOJ and SEC were focused very squarely on Fairfax because they were looking at statements that Mr. Larson had made in a February press conference where he said, oh, our problems are only limited to OdysseyRe's, a subsidiary, accounting, it turns out, no, they were looking -- the government thought that was a false statement.

And what does this all say? It says, we, the investors, know there are problems with the accounting with this company. We know the government is looking at these problems. And ultimately -- and they valued that and said, OK, they reduced the share price accordingly. I think on March 22 alone they lost 13 percent of their value because people were concerned that there was something wrong with the company. Ultimately, after the class period, the restatement comes out, which was prompted, I think there's no doubt, prompted by the existence of all these SEC and DOJ investigations. They do a

restatement. The restatement flows from the investigations that are disclosed. I think what turns out is that probably the restatement was not as bad as was thought by investors it could be. So the price goes up. That doesn't mean that the concerns weren't there. That just means that the market viewed them as more substantial than they ultimately turned out to be. I think a reasonable example is what happened last week. JP Morgan Chase released a restatement announcing that they had a $5.8 billion loss with respect to certain derivative trading activity. The price went up.

THE COURT: They first said it is 2.2. But they still had pretty good profits, if you're going to argue about Chase Morgan.

MR. JARVIS: Yes, but the point is, though, no one said $5.8 billion is immaterial. The fact that the price went up just meant that the market had -- they were more concerned, they were afraid it was going to be worse. And I'm afraid that that's what happened with respect to the restatement in this case. They were afraid that it would be worse. So the serial chain of loss causation is all the announcements that there are government investigations into a company that is perceived to be nontransparent, difficult, and which ultimately causes restatements; we can see exactly how much it was.

THE COURT: I said I had two questions.

MR. JARVIS: Yes. Your second question, your Honor.

THE COURT: Well, Ms. Nguyen said that you were going to handle what I thought was the Tenth Circuit case, which went into the history of the 1933 and 1934 Acts. That's the case *Anixter v. Home Stake Productions*.

MS. NGUYEN: I'm sorry, your Honor. I said that the *Judith v. Wiles* opinion actually discussed *Anixter*. I didn't mention Mr. Jarvis.

THE COURT: Oh, I misunderstood you. Well then, I'll ask you, how do you, in spite of the fact that I misunderstood Ms. Nguyen, how do you get around this statement by the Tenth Circuit, "The legislative history reinforces the conclusion that the period" -- the period of repose, that is -- "is an outside absolute period"? It's not like the statute of limitations.

MS. NGUYEN: Yes, your Honor. If you accept the reasoning in *American Pipe*, that it's a class action and Rule 23 policy considerations apply, such that unnamed class members satisfy the repose period --

THE COURT: What about what Judge Kaplan said that I read?

MS. NGUYEN: Judge Kaplan?

THE COURT: Yes. Remember I read a quote from Judge Kaplan.

All right. There's no point going over it. I can read what is in the record.

OK. Why don't you conclude, then.

MR. JARVIS: Let me just -- I will stand on our briefs. A couple other quick points.

THE COURT: Yes, briefly.

MR. JARVIS: Loss causation. One of the points that the defendants make is that, oh, by the way you sold out, your client sold out, before the last disclosure on March 22, and is out of the case. And they cite basically *Flag* and the Second Circuit cases *Dura*, both of which say there has to be a corrected disclosure. And we didn't really address that in our primary brief so I just wanted to give your Honor a couple cases that your Honor could think about. In the class certification context, that issue comes up a lot. In other words, the claim is, you can't certify a class that goes to the end because a particular lead plaintiff sold out before the end, or you can't get purchases from the beginning because a particular lead plaintiff purchased later.

There are two cases there that I think are interesting on that. There are some that are older, *Feldman v. Motorola*, 1993 WL 497228, and *Schleicher v. Wendt*, 2009 WL 761157, from the Southern District of Indiana. And what they both basically say is, you don't have to have a plaintiff who has purchases essentially on every day of the class period. The class who bought on every day of the class period, the lead plaintiff, is a representative plaintiff as long as they have a standing that

they haven't sold after some disclosures, they have some things. We're not going to say that they have to apply on the first day and sell on the last day and that the class is coextensive with the purchase history. The lead plaintiff cases just don't do that. And cases on loss causation simply are not particularly relevant. This is really -- there's no argument -- there's an argument, but certainly the argument, if you buy our loss causation argument, there are correct disclosures here. The question is whether this plaintiff should be allowed to stand in for everybody who did buy. So I wanted to address that, because we did not address that in our brief.

And on Section 11 standing, I just wanted to refer the Court to the Judge Bear decision in *Sirius XM*, which is a case where Judge Baer basically said that as long as plaintiffs have standing to sue defendant on certain grounds, at some time they should. They don't have to have every single claim. In this particular case, which is I think different from the residential mortgage-backed securities cases that are cited by defendants, there's no question we're all relying on the same false statements in various respects, albeit in the 10b context they brought up earlier. The only question is whether they bought an offering, and we would argue that under *Sirius XM*, that they simply don't have to have bought in an offering to have standing to pursue them.

THE COURT: I think I have your point.

MR. JARVIS: Thank you, your Honor.

THE COURT: Thank you very much. Decision is reserved.

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